

REPORT OF EXAMINATION  
OF THE  
TIG SPECIALTY INSURANCE COMPANY  
  
AS OF  
DECEMBER 31, 2005

Participating State  
and Zone:

California  
Delaware, Zone 1 – Northeastern

Filed June 28, 2007

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Los Angeles, California  
May 29, 2007

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Kent Michie  
Secretary, Zone IV-Western  
Commissioner of Insurance  
Department of Insurance, State of Utah  
Salt Lake City, Utah

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Honorable Thomas E. Hampton  
Secretary, Zone I-Northeastern  
Commissioner of Insurance  
Department of Insurance, Securities and Banking  
Washington, D.C.

Dear Chairman, Secretaries and Commissioner:

Pursuant to your instructions, an examination was made of the

#### TIG SPECIALTY INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 250 Commercial Street, Suite 5000, Manchester, New Hampshire 03101. The Company's statutory home office and main administrative office is located at 8880 Rio San Diego Drive, Suite 510, San Diego, California 92108.

#### SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2005. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. An examiner from Delaware, representing Zone I-Northeastern of the NAIC, participated in the examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the

examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances.

This examination was conducted in conjunction with the examination of the Company's parent, TIG Insurance Company and three affiliates, TIG Indemnity Company, Fairmont Premier Insurance Company and Fairmont Insurance Company.

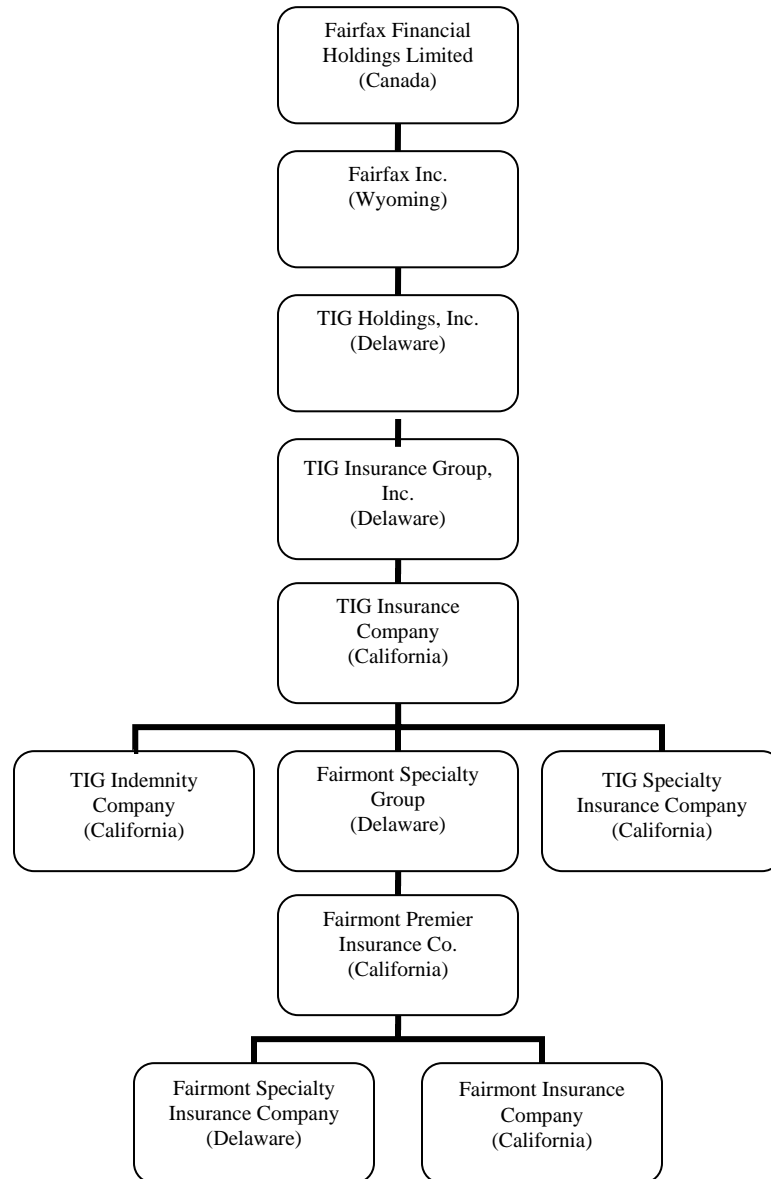
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; loss experience; accounts and records; and sales and advertising.

### COMPANY HISTORY

On December 16, 2002, Fairfax Financial Holdings Limited (Fairfax), the Company's ultimate parent, decided to discontinue the operations and to run-off the existing book of business written by the Company's immediate parent, TIG Insurance Company (TIG), and TIG's subsidiaries including the Company. Because of contractual requirements with certain Managing General Agents (MGA's) and Managing General Underwriters (MGU's), the Company continued to write relatively substantial amounts of business throughout 2003.

### MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's parent along with certain of its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



all ownership is 100%.

Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving as of December 31, 2005 follows:

## Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Richard S. Donovan South Lake, Texas	President TIG Insurance Company
Dennis C. Gibbs Bedford, New Hampshire	Chief Executive Officer TIG Insurance Company
Robert L. Gossett Seabrook, New Hampshire	Senior Vice President TIG Insurance Company
John M. Parker Manchester, New Hampshire	Senior Vice President, Secretary TIG Insurance Company
Michael J. Sluka Hooksett, New Hampshire	Chief Financial Officer TIG Insurance Company

## Principal Officers

<u>Name</u>	<u>Title</u>
Richard S. Donovan (*)	President
John M. Parker (**)	Senior Vice President and Secretary
Michael J. Sluka	Senior Vice President and Treasurer
Frank J. DeMaria	Senior Vice President

(\*) Replaced by William J. Gillett effective August 16, 2006

(\*\*) Replaced by Charles G. Ehrlich effective December 15, 2006

## Management Agreements

Service Contract and Expense Sharing Agreement: The Company has a Service Contract and Expense Sharing Agreement with its parent, TIG Insurance Company, effective December 31, 1989. The agreement is continuous and unlimited in duration. The agreement applies to all shared functions of the two companies which includes: personnel service requirements, all home and service office space, supplies, business equipment and all other requirements for the conduct of business of the respective

parties that may be provided by the Company. The agreement does not apply to allocated claims expenses, fees for maintaining investment management services nor federal income taxes. For 2004, and 2005 fees paid by the Company under this agreement were \$44,000, and \$73,000. respectively.

Tax allocation agreement: The Company is party to an agreement with its intermediate parent, TIG Holding, Inc., dated January 1, 2000, whereby it files its' federal income taxes on a consolidated basis along with 50 other affiliated companies. Each Company computes its' federal income tax liability or refunds on a separate basis and estimated tax balances are settled quarterly. Tax adjustments are settled annually when the tax return is filed. This agreement was approved by the California Department of Insurance (CDI) on January 22, 2001. The Company's federal income taxes incurred portion for 2003, 2004, and 2005 were \$344,000, \$318,000, and \$280,000, respectively.

Investment Agreement: The Company is party to an agreement with Hamblin Watsa Investment Counsel Ltd. (HWIC) and Fairfax Financial Holdings Limited (Fairfax) effective January 1, 2003. Pursuant to the agreement, HWIC manages the investments of the Company in accordance with specific investment objectives outlined in the agreement. All fees are paid by the Company to Fairfax, and Fairfax then reimburses HWIC for investment management services. HWIC is a subsidiary of Fairfax. The CDI approved the agreement on December 3, 2003. The fees paid by the Company for 2003, 2004, and 2005 were \$71,000, 86,000, and \$89,000, respectively.

#### TERRITORY AND PLAN OF OPERATION

As of December 31, 2005, the Company was licensed to transact multiple lines of property and casualty insurance. The following is the states in which the Company is licensed: Arizona, California, Colorado, Nevada, and Washington.

In addition, the Company wrote business on a surplus-lines basis in the District of Columbia, and all of the remaining states with the exception of Maine.

The direct premiums written by the Company during the examination period were as follows:

<u>Year</u>	<u>Premium</u>
2002	\$64,783,057
2003	53,917,877
2004	1,108,591
2005	(84,050)

Despite the 2002 announcement of the intention to enter runoff the Company continued to write relatively significant amounts of direct premium during 2003 because of contractual requirements with certain Managing General Agents (MGA's) and Managing General Underwriters (MGU's).

### REINSURANCE

#### Assumed

The Company has no reinsurance assumed.

#### Ceded

The Company pursuant to a long-standing quota-share treaty ceded 100% of the business to its parent, TIG Insurance Company (TIG), on a gross basis. This still-current agreement became effective October 1, 1995, and was entered into for an indefinite period. The agreement was approved by the California Department of Insurance on November 3, 1995. The Company had no other ceded treaties.

As of December 31, 2005, reinsurance recoverables, for all ceded reinsurance totaled \$162 million or 549% of surplus as regards policyholders. The ceded reinsurance recoverables were all from the Company's parent TIG.



## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2002 through December 31, 2005

Statement of Financial Condition  
as of December 31, 2005

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 11,498,079	\$ 11,498,079	
Cash and short-term investments	18,138,344	18,138,344	
Investment income due and accrued	126,933	126,933	
Aggregate write-ins for other than invested assets	<u>1,252</u>	<u>1,252</u>	
Total assets	<u>\$ 29,764,608</u>	<u>\$ 29,764,608</u>	
<u>Liabilities, Surplus and Other Funds</u>			
Losses		\$ 0	
Losses and loss adjustment expenses		0	
Current federal and foreign income taxes		94,635	
Net deferred tax liability		111,221	
Payable to parent, subsidiaries and affiliates		<u>102</u>	
Total liabilities		205,958	
Common capital stock	\$ 4,100,000		
Gross paid-in and contributed surplus	22,500,047		
Unassigned funds (surplus)	<u>2,958,603</u>		
Surplus as regards policyholders		<u>29,558,650</u>	
Total liabilities, surplus and other funds		<u>\$ 29,764,608</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income

Premiums earned		\$ 0
Deductions:		
Losses incurred	\$ 0	
Loss expense incurred	0	
Other underwriting expenses incurred	<u>0</u>	
Total underwriting deductions		<u>0</u>
Net underwriting gain or (loss)		0

Investment Income

Net investment income earned	\$ 955,155	
Net realized capital gains	<u>422,238</u>	
Net investment gain		<u>1,377,393</u>
Net income before federal and foreign income taxes		1,377,393
Federal and foreign income taxes incurred		<u>279,886</u>
Net income		<u>\$ 1,097,507</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2004		\$ 28,559,897
Net income	\$ 1,097,507	
Change in net deferred income tax	<u>(98,754)</u>	
Change in surplus as regards policyholders		<u>998,753</u>
Surplus as regards policyholders, December 31, 2005		<u><u>\$ 29,558,650</u></u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2002 through December 31, 2005

Surplus as regards policyholders, December 31, 2002, per Examination			\$ 27,634,276
	Gain in Surplus	Loss in Surplus	
	<hr/>	<hr/>	
Net income	\$ 1,948,058	\$	
Change in net deferred income tax	<hr/>	<hr/>	23,684
Total gains and losses	<u>\$ 1,948,058</u>	<u>\$</u>	<u>23,684</u>
Net change in surplus as regards policyholders for the examination			<u>1,924,374</u>
Surplus as regards policyholders, December 31, 2005, per Examination			<u>\$ 29,558,650</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

None

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None

Previous Report of Examination

None

## ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

\_\_\_\_\_/S/\_\_\_\_\_  
Gary W. McMurray, CFE  
Examiner-In-Charge  
Contract Insurance Examiner  
Department of Insurance  
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